

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
PACIFIC FINANCE CORPORATION }

Appearances:

For Appellant: H. S. Bergstrom, Controller; B. C. Reynolds,
Assistant Controller of Appellant Corporation
For Respondent: Chas. J. McColgan, Franchise Tax Commission

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Pacific Finance Corporation to a proposed assessment of an additional tax in the amount of \$674.19, for the year beginning January 1, 1934 and ended December 31, 1932.

The only question involved in this appeal relates to the proper method of computing the tax liability for the second taxable year of corporations commencing to do business for the first time after the effective date of the act as members of an affiliated group already in existence.

It appears that during the year 1931, Appellant and ten subsidiaries were in existence and at the close of that year filed a consolidated return for the year 1931. Three of the subsidiaries, Pacific Finance Corporation of California, Pacific Company of California and Los Angeles Industries, Inc., commenced doing business for the first time after the effective date of the act during 1931. Of these three commencing corporations, Pacific Finance Corporation of California operated nine months and realized a net income of \$51,938.11; Pacific Company of California operated seven months and realized a net income of \$10,949.03; and Los Angeles Industries, Inc. operated one month and sustained a loss of \$4,555.33.

Section 13 of the Act as amended in 1931 provided that in the case of a corporation commencing to do business in this State for the first time after the effective date of the Act, the tax for the first taxable year should be computed upon the net income of that year, and for the purpose of computing the tax for the second taxable year, the net income for the first taxable year should be increased in the proportion which the number of months in the second taxable year bears to the number of months in the first taxable year, i.e., placed on an annual basis.

It should be noted, however, that Section 14 of the Act

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provided that in lieu of separate returns, an affiliated group of corporations should have the privilege of filing a consolidated return. Although the Act did not expressly provide what effect should be given to a consolidated return, it was apparently contemplated that if certain members of an affiliated group sustained losses, the losses could be used to reduce the net income of other members of the group, with the result that the tax liability of the group would be less than it would be if the tax liability of each member of the group were computed separately on the basis of separate returns.

In computing the tax liability of Appellant and its ten subsidiaries for the year 1932, the Commissioner allowed the filing of a consolidated return covering their activities for the year 1931, but, in accordance with the provisions of Section 13 of the Act, the net income of Pacific Finance Corporation of California was increased from \$51,938.11 to \$69,250.81, and the net income of Pacific Company of California was increased from \$10,949.03 to \$18,769.77.

The Appellant. ~~does~~ not question the action of the Commissioner in placing the net income of the above corporations on an annual basis, but contends that the Commissioner did not give proper consideration to the net loss of \$4,559.37 sustained by Los Angeles Industries, Inc.

From a careful examination of the records of the Commissioner, we are convinced that the net income of the affiliated group was reduced by the actual loss of the Los Angeles Industries, Inc. Appellant contends, however, that if the net income of the commencing corporations which realized net income is placed on an annual basis, the net loss of Los Angeles Industries, Inc. should also be placed on an annual basis, and hence should be increased to \$54,712.44.

We are unable to find any provision in the Act which authorizes such a procedure. Appellant argues that the term "net income" as used in Section 13 should be construed as referring to the net result of a corporation's activities during its first taxable year regardless of whether the corporation operated at a profit or loss. Obviously, this construction would result in giving to the term "net income" as used in Section 13 of the Act a meaning entirely different from the meaning to be ascribed to the term as used in other sections of the Act, and is, we think, entirely unwarranted either by authority or reason.

Appellant argues that in computing the tax liability of the consolidated group it is extremely inconsistent to place the net income of the commencing corporations which had net income on an annual basis without at the same time according similar treatment to the net loss of the commencing corporation which sustained a net loss. That this action of the Commissioner is inconsistent may be conceded. But if the inconsistency must be remedied, the remedy, we think, is to compute the tax liability of the commencing corporations for their second taxable year entirely in accordance with the provisions of Section 13 without

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regard to the consolidated return of the entire group. It is significant to ~~note~~ that the Legislature has amended Section 14 of the Act to provide that this procedure shall be followed in the future (Statutes of 1933, Chapter 303). Under this procedure, neither the actual loss of Los Angeles Industries, **Inc.**, nor that loss adjusted to an annual basis could be used to reduce the net income of the other members of the affiliated group.

By filing a consolidated return, Appellant obtained the advantage of a reduction in the franchise tax liability of the consolidated group as compared to what that liability would otherwise have been, to the extent that the loss sustained by Los Angeles Industries, Inc. reduced the net income of the **affiliated group**. We are unable to perceive that Appellant is entitled to any greater advantage on account of that loss,

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of the Franchise Tax Commissioner in overruling the protest of Pacific Finance Corporation against a proposed assessment of an additional tax in the amount of \$674.19, based upon the net income of said corporation for the year beginning January 1, 1932 and ended December 31, 1932, be and the same is hereby sustained.

-Done at Sacramento, California, this 21st day of June, 1933, by the State Board of Equalization.

R. E. Collins, Chairman
Fred E. Stewart, Member
Jno, C. Corbett, Member
H, G. Cattell, Member

ATTEST: Dixwell L, Pierce, Secretary